

MGT388 THIRD FORMATIVE TEST – FINANCIAL MANAGEMENT

5 QUESTIONS (ESTIMATED TIME: 9 MINUTES)

ANSWERS

Each correct answer: 2 marks Each wrong or not given answer: 0 marks

1) Which one of the following statements is correct?

- a. A partnership has the advantage of limited legal liability.
- b. Partnerships pay corporation tax on their profits.
- c. The partnership structure does not allow that business risks are shared between the partners.
- d. The partnership structure is suitable for most sectors of business activity.

ANS: D

2) Samer runs a small auditing firm with his partners Key and Bill. Which one of the following items is among liabilities of their business?

- a. Office laptops.
- b. Investments in bonds.
- c. Professional subscriptions payable.
- d. Amounts due from clients in respect of audit fees.

ANS: C

3) Rossi & Smith plc is listed on the main market of the London Stock Exchange. The company has 2 000 000 ordinary shares in issue, with a nominal value of 50p per share. Shares in the company currently trade at 85p, but the average price of one share over the last year has been 95p. The company's directors are planning a rights issue to take place next month at a price of 90p. What is the company's market capitalisation?

- a. £1 000 000
- b. £1 800 000
- c. £1 900 000
- d. £1 700 000

ANS: D

- a. $2\,000\,000 \times 50p = £1\,000\,000$ - incorrect
- b. $2\,000\,000 \times 90p = £1\,800\,000$ - incorrect
- c. $2\,000\,000 \times 95p = £1\,900\,000$ - incorrect
- d. $2\,000\,000 \times 85p = £1\,700\,000$ - correct

4) The directors of Jeffery and Grant Limited are currently considering the replacement of part of their production line. Relevant data for machine Y are as follows:

Initial investment at time 0	600 000
Net cash inflows from machine	
Year 1	210 000
Year 2	220 000
Year 3	200 000
Year 4	150 000

Which one of the following statements is correct?

The payback period for the proposed investment is (to the nearest month):

- | | |
|--------------------------|-------------------------|
| a. 4 years | c. 2 years and 2 months |
| b. 2 years and 10 months | d. 1 year and 10 months |

ANS: B

Cumulative cash flows:

	Cash flow £	Cumulative £
Initial investment	- 600 000	- 600 000
Year 1	+ 210 000	- 390 000
Year 2	+ 220 000	- 170 000
Year 3	+ 200 000	+ 30 000

Payback period:

2 years + $(170/200 \times 12 \text{ months}) = 2 \text{ years } 10 \text{ months (to nearest month)}$

- a. 4 years (the whole period over which cash flows arise) - incorrect
- b. 2 years 10 months - correct
- c. 2 years 2 months (i.e take 2 years + $[30/200 \times 12 \text{ months}]$) - incorrect
- d. 1 year 10 months (i.e. take fraction as in c. and deduct from 2 years) – incorrect

5) Which is the missing phrase in the following sentence?

A weakness of the ____ method of investment appraisal is that it cannot be used where the pattern of cash flows is irregular, with a mixture of cash inflows and cash outflows.

- | | |
|------------------------------|----------------------------|
| a. net present value | c. payback |
| b. accounting rate of return | d. internal rate of return |

ANS: D

